

Global Custody

Global Finance brought together some of the world's leading custody experts to discuss the industry's prospects.

GLOBAL FINANCE: Welcome. Please tell us a little about your organizations.

MARY BAKER BALADY, senior vice president, global custody executive, JPMorgan Worldwide Securities Services: If we look today at what's changed in the industry, what our clients are asking for, it's clear there are some keys to success. Having scale and experience is the minimum "ticket to play" in the custody game. The scale of a JPMorgan means that clients can come to one firm for all their needs, and that is key in today's marketplace. JPMorgan has been in the business for a long, long time—some client relationships date back to 1933—and we coined the phrase "global custody" in 1974. We offer deep and extensive experience that no smaller firm can. And our client focus is not just talk; we have client coverage that is second to none. Our clients and their needs are complex, and it's through our experience, our focus on innovation and our technology that we

can deliver to them. Technology is incredibly expensive; whether you're on the buy side or sell side, to meet the changing marketplace, to meet some of the new regulations, it's critical to invest in technology. So again, by being part of a large-scale business and an even larger parent company, JPMorgan, it enables us to have the financial wherewithal and the innovation to focus on ways to help our clients help their clients.

BETH FORTIER, vice president, JPMorgan Network Management: We're fortunate in having the ability to leverage our technology to deliver information through our client-facing websites, as well as our position across the globe to deal with clients on a daily basis through dialogue around the key issues and challenges they're facing. We have a number of leadership positions in the industry. For example, we have been appointed as an expert adviser to the European Parliament on clearing and settlement, and we're called on a regular basis to assist

with formulating new regulations in local markets. It's our goal to create client-centric solutions—to really understand what our clients desire—and get in front of them and create those solutions where they don't exist today.

FEDERICO VIOLA, relationship manager, securities products, Banca Intesa: Service-wide, Banca Intesa is a leading player on the Italian market and may be the sole indigenous group able to provide the whole range of transaction-based services via a unified business structure, encompassing product development, client relationships, operations. We can count on a sophisticated and flexible IT platform, fully integrated with the custody, settlement, cash and in-house treasury functions. These factors allow our clients to rely on a unique, synergic, dedicated transactions service environment. We provide a full range of products, including sub-custody and clearing, to a wide client base such as mutual funds, pension funds, banks, global custodians, ICSDs, broker-dealers. We leverage our local and market expertise on their behalf. We have different categories of clients with different needs. Global custodians and financial institutions—mainly insurance companies, mutual funds and pension funds—have different needs, but they have something in common: They want responsiveness, craftiness, efficiency and attention to cost savings.

WILL GIBSON, chief operating officer and chief financial officer, New York Life Investment Management: We have a variety of clients—mutual funds, the insurance company itself, pension funds, high-net-worth individuals and 401(k)



clients—for whom we are acting as the investment management. The place where we do our best is to “chase alpha.” We are able to get a better return for our clients because of our investment capabilities, but if it were not for our custodians and our service providers, whatever alpha we would be able to generate from our investment activity would be eaten away because of inefficiencies in back-office operations and the market. Our custodian providers help us in terms of facilitating clearing, in settlement, in custody, as well as helping us with our technology.

PAT CURTIN, executive vice president, head of the investor services businesses, The Bank of New York: I believe this industry is still on the brink of a very significant change. While a lot of change has happened in this industry over the past five years, I think the change we’ll see in the next five years is going to dwarf it. There is still significant overcapacity in the global custody industry. There are perhaps eight truly global providers. In five to seven years that probably won’t be more than four players. Margins in this business have compressed; it’s got all the characteristics of an oligopoly while at the same time it has some of the characteristics of a highly commoditized business, making it more difficult for each of us to differentiate ourselves. Also, while technology is incredibly important and capital spending has been on the rise as it relates to technology, I believe technology is not and cannot create a sustainable competitive advantage for any one provider. When you add all those things together, the landscape of the industry has no choice but to change.

BAKER BALADY: If you don’t have the scale, you can’t invest in innovation, you can’t invest in the technology, and that’s going to be critical in this changing marketplace. Also, it’s not just the technology: We are high tech, but we are still high touch. Speaking of change, one of the avenues that we’ve pursued is supporting our clients who are chasing alpha. We anticipated this several years ago, and we can now offer an integrated solu-



Viola: You have to be able to absorb technology shocks, to absorb the market changes



Fortier: There’s been a significant increase in regulatory requirements, which is painful for all participants

tion, whether it be derivatives or hedge fund servicing; our purchase of Tranaut showed our leadership in this area. We’ve also led innovations in products and services like JPMorgan VIEWS, which is now the best in the industry.

GIBSON: Custody is not what it was four years ago because at one point there were very few entities that would proudly define themselves as a “local custodian”; they all had aspirations to be global custodians. A number of institutions have recognized they can’t compete in that market, but they now have pride in being part of a sub-custody network, or providing local custody services for individuals or entities that are in the local market that want to have custody only in that market, or an international client that wants to buy securities in that local market. As a result, you’re finding a commoditization in one sense, but you’re also seeing a high degree of specialization. When we’re looking at a service provider, what we really have to look at is, Do we want someone who is going to be a global participant, or do we want someone who’s going to be able to help us specialize?

CURTIN: There are other services that custodians have brought to the market

that five or six years ago would never have been thought to be offered by the custody industry. Outsourcing is a great example of the expansion of scope of what custody providers are bringing to the marketplace. But with that expansion has come a “land grab” mentality that has helped drive prices to the point where they are maybe out of equilibrium.

GIBSON: Most economic analyses I’ve seen say it’s impossible to make money in pure, simple, basic custody, but that’s why the client relationship you have is crucial. The custodial relationship with the investment management firm gives you the opportunity to look at their entire portfolio and to step in and say, “You may not be aware of this but we could help you.” That has evolved into this entire range of additional value-added services.

BAKER BALADY: I think you can make money. It’s critical that you have a very good understanding of your costs and of the profit dynamics of every piece of business. If you look at what you’re being asked to provide, it generally is not custody alone. We’ve seen very few deals that are custody alone. You need to have an array of businesses, the businesses where you’re offering cash solutions, se-

curities lending, transition management and other value-added services.

VIOLA: We have been assisting a progressive shift from traditional custody and settlement services to “value-added” services—from market intelligence, to securities lending, in-sourcing of back-office/administrative functions, solutions to enhance cash and liquidity management—to the point that I doubt they could be considered “additional” services. At the same time the core products have had to become more robust and sophisticated themselves. Banca Intesa has, for instance, developed highly sophisticated multi-party clearing services and customized value-added CSD account management and reporting services that complement our fiscal representative and issuer reporting services for non-resident intermediaries.

GF: The custody business has come through a period of intense regulatory scrutiny. What is the current regulatory environment, and how do you see it in the near future?

FORTIER: There’s been a significant increase in the level of regulatory requirements, compliance requirements

and so on, and they’ve been painful for all participants. We at JPMorgan are fortunate to have an extensive support network in terms of our risk management and compliance teams, as well as unique technology that helps us to undergo self-assessment, as well as leverage for our clients in their own regulatory reporting and assessments.

CURTIN: I feel at least the pendulum has stopped the momentum it had in the direction of intense regulatory scrutiny on the part of every regulator that had an interest in what custodians were doing. That is absolutely from a global perspective. Every aspect of our role as custodian has been under some degree of inquiry, but the pendulum is slowing down.

GIBSON: In the custody environment there is a tendency to over-regulate, which inhibits the ability of people to do business. I hope the pendulum starts to come back to a period of normality.

BAKER BALADY: We’re feeling the effects, certainly; if you look at the ADR business, the regulations have all but wiped that business away. People are looking for other markets to launch because they can’t deal with all the regulations in America.

VIOLA: There are multiple variables underpinning the determination of the regulatory framework, and we are constantly dealing with taxation, accounting, corporate responsibility, risk management, business continuity, settlement finality and so on, so it’s part of the service. It is also an opportunity to leverage our expertise.

GF: Alternative forms of investment are capturing a larger share of funds around the world. What have custodians done to better service investors in these alternative investments?

BAKER BALADY: We’ve created one unit that is focused on alternative investing and covers everything from hedge fund administration to derivatives processing, real estate—whatever form of investing the clients are looking for. We’ve seen dramatic increases in volumes on alternatives. Our clients look to us not only for the actual processing but very often for some kind of consulting advice as well.

CURTIN: We, too, have paid a significant amount of attention to the alternative space. We put it within a concentrated unit with hedge fund administration, derivatives processing, venture capital, et cetera. One major product innovation that this industry has brought to its client base in this space is the ability to handle alternative investment processing, alternative investment accounting and alternative investment valuation.

VIOLA: The alternative investment industry remains a niche in Italy. The support of the custodians on that side has been, first of all, at the market level. This means contacts with the regulators, full assistance and support from an administrative perspective. Banca Intesa has been the first depo bank serving pure single-manager Italian hedge funds. The market is growing in providing traditional services and new service support to the hedge funds. Outsourcing (fund admin and fund accounting) for the first time has been officially approved for custodians/Italian depo banks, and Banca Intesa is already positioned at the forefront of the industry with resources and knowl-



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edge to support the hedge fund as well as the overall mutual funds and asset management arena.

GF: Technology continues to drive change in the custody business. What major developments should we be aware of?

CURTIN: We like to focus much more on information delivery. Technology is simply a tool that helps us get there. One of the fundamental philosophical changes that's taken place is that our business today is about a lot more than the custody of securities. The focus has become the custody of information. So the greatest change that will continue to occur is how you can use technology to be in the business of investment information creation.

BAKER BALADY: Technology is an enabler, not only for us but for the clients themselves. We recently launched a new client platform, called VIEWS, that provides information reporting, et cetera. It's extremely comprehensive, easy to use and customizable, and the clients who are on it today have been incredibly excited. They're looking for value added, and I think our job is providing them the information and enabling them to customize it so it becomes valuable for them.

GIBSON: As a buyer I would submit that the organizations here are in the business of data arbitrage. I really don't care what one does behind the scenes; it's getting the clients that data that allows us to do our jobs better. The value added of the custodial provider is that they enhance and enable.

VIOLA: I would agree about the focus on info delivery and on the importance of making information available, translating and delivering available information to the clients. That's a field where we have been investing a lot of time and resources. At the same time, the closer you get to the market structure, the higher would be also your "rude" IT investment requirements: You have to be able to absorb technology shocks, to absorb the market changes and so on. You have to deal with new taxation requirements, settlement



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Global Finance publisher Joseph Giarraputo: Does technology continue to drive change in custody?

systems, regulatory paths. The more you are prepared to internalize such things, the happier your clients will be. The recent introduction of Express II, the new settlement system in Italy, can be a very good case study on "buffering" capabilities of the agents. From the operational and IT management perspective, we are becoming more and more demanding with our IT functions, to become more flexible, closer to the market and eventually to our clients.

GF: Tell us about advances in the way custodians deliver information to clients and provide reporting and analytics.

BAKER BALADY: We are integrating tens of thousands of data elements—not just from the clients' own portfolios, but market data as well—and allowing our clients to have the power. It's made us more efficient in our own office and helps the clients in their offices.

VIOLA: We have a very sophisticated Internet communication platform for our clients, called SetWeb. It provides real-time information on cash and securities accounts, balances, movements, real-time status on settlement transactions and so on. On top of this we have new facilities

that provide our clients the capacity on-line access varying from tax-related reporting, overview on all the accounts and fiscal documentation in place, billing details in the cash and securities business, instruction tools, et cetera. It's a big step and perceived as powerful by our clients.

CURTIN: The Bank of New York has an integrated Internet delivery platform, called INFORM, which has been under constant enhancement for the better part of the decade, delivering all sorts of information and analytics for our clients. There is a constant race to provide more information that helps clients monitor, sort and analyze the vast amount of information they need to maximize their assets.

FORTIER: We have fabulous information that's truly accessible to our clients, but you still have to have the experts available to the clients who can answer their questions and meet their needs directly.

GIBSON: If the industry would agree to try to eliminate some of the operational friction in the back office, it would make a great leap forward in the industry. The Internet has been a tremendous thing, but there are still significant opportunities that exist. ■